

Q. If the Board were to determine that the accrued revenue as a result of a change in the revenue recognition policy should be fully recognized in 2006, with no other considerations other than tax implications, what effect, giving detailed reasons, would this decision have on the financial and operational plans of NP?

A. Under the scenario proposed (the “Full Recognition Scenario”), the entire forecast 2005 accrued revenue of \$24,262,000¹ would be recognized for regulatory purposes in 2006.

Attachment A provides the Company’s forecast 2006 financial results comparing proposals contained in the 2006 Accounting Policy application to the Full Recognition Scenario suggested in this Request for Information.

The comparative impacts are summarized in Table 1.

Table 1
Forecast 2006 Impacts
Newfoundland Power Proposal vs. Full Recognition Scenario

	Newfoundland Power Proposal	Full Recognition Scenario
Rate of Return on Rate Base	8.56%	8.86%
Regulated Rate of Return on Book Equity	9.24%	10.06%
Excess Revenue (000s)	-	\$11,815

From an accounting perspective, the Full Recognition Scenario is the simplest approach to deal with the proposed change in accounting policy.

Under the Full Recognition Scenario, the Company’s forecast 2006 rates of return are (i) higher than calculated under the Newfoundland Power proposal and (ii) at the upper end of the range of the currently recognized just and reasonable rates of return.² Under the Full Recognition Scenario, excess revenue of \$11,815,000 is forecast for 2006.

The Full Recognition Scenario would not materially alter the financial and operational plans of the Company from those which would result from the Board’s approval of the proposals contained in the 2006 Accounting Policy Application.

The Full Recognition Scenario would increase Newfoundland Power’s 2006 returns by approximately \$2.9 million from those forecast in the 2006 Accounting Policy Application.³ It would correspondingly reduce the amount of the total accrued revenue available for future benefit of customers.

¹ See page 4 of Exhibit NP-3 in Newfoundland Power’s evidence.

² The approved rate of return on rate base is currently 8.68%, in a range of 8.50% – 8.86%. The 8.68% rate of return on rate base is based upon a rate of return on common equity of 9.24%.

³ The \$2.9 million increase in forecast 2006 return is different from the \$2.3 million referred to in the Response to Request for Information PUB 9.0 NP. This is due to differences in the transitional adjustment to rate base for 2006 which results from the Full Recognition Scenario and the Two-Year Scenario. The transitional adjustment is described in the Company Evidence, pp. 24-25.

Newfoundland Power Inc.

2006 Forecast

**Newfoundland Power Proposal vs. Full Recognition Scenario
(000s)**

	<u>Newfoundland Power Proposal¹</u>	<u>Full Recognition Scenario²</u>
1		
2		
3	Billed Revenue	\$ 417,069
4	2006 Unbilled Revenue Accrual	457
5	2005 Unbilled Revenue Accrual	9,579
6		<u>12,447</u>
7		427,105
8	Purchased Power Expense	429,973
9		<u>265,498</u>
10	Contribution	265,498
11		<u>161,607</u>
12		
13	Other Revenue	9,950
14		<u>9,950</u>
15	Other Expenses:	
16	Operating Expenses	54,153
17	Depreciation	54,153
18	Finance Charges	39,079
19		<u>32,637</u>
20		125,869
21		<u>125,869</u>
22	Income Before Income Taxes	45,688
23	Income Taxes ³	48,556
24		<u>15,335</u>
25	Net Income	30,353
26	Preferred Dividends	33,221
27		<u>591</u>
28	Earnings Applicable	
29	to Common Shares	\$ 29,762
30		<u>\$ 32,630</u>
31	Excess Earnings	-
32		11,815
	Rate of Return Metrics	
	Regulated Return on Book Equity	9.24%
	Rate of Return on Rate Base ⁴	10.06%
		8.56%
		8.86%

¹ See Exhibit NP-14, Page 1 of 5.

² Assumes recognition of revenue for regulatory purposes based on the accrual method and all consequential matters as detailed in the 2006 Accounting Policy Application adjusted to reflect the Board's request for information.

³ Income tax expense on the 2005 Unbilled Revenue is determined by the tax settlement. It is therefore unaffected by the amount of 2005 Unbilled Revenue that is recognized for

⁴ In Order No. P.U. 50 (2004), Newfoundland Power's rate of return on rate base, used to set customer rates for 2005, was approved at 8.68% in a range of 8.50% to 8.86%.